

## **Chapter 6**

### **Takaful Industry in Malaysia**

#### **6.1 Background**

It is a Muslim's belief that any misfortune that befalls him, that results in the loss of life or belongings, is by the will of the Almighty Allah. At the same time, we also taught to take positive steps to avoid or reduce the possibility of these misfortunes as indicated by the hadith:

"The Prophet (pbuh) told a Bedouin who left his camel untied to the will of Allah: Tie your camel first, then put your trust in Allah".  
(Narrated by At-Tirmizi and Ibn Majah)

Nowadays, insurance is seen as a means of action undertaken to reduce the risk of loss due to misfortunes. An alternative form of cover a Muslim can avail himself against the consequences of catastrophe and disaster is by participating in Takaful schemes.

It is a scheme based on solidarity, shared responsibility and brotherhood among members. Participants of this scheme all agree to mutually help each other by contributing financially on the basis of "tabarru" (donation). Insurance as a concept does not contradict the practices and requirement of Shariah. In essence, insurance is synonymous to a system of mutual help.

It is the pooling of resources to help the needy, a scheme which is similar to the principles of compensation and shared responsibility among the community, as practiced between the Muhajirin of Mecca and the Ansar of Medina following the hijrah of the Prophet over 1,400 years ago. However, Muslim jurists are of the opinion that the operation of the conventional insurance, in its present form,

does not conform to the rules and requirements of shariah as it embodies the following three elements:

- (a) Gharar: The unknown or uncertain factors in operation of a contract in life insurance contracts;
- (b) Maisir: Gambling arises as the consequences of the presence of the Gharar, particularly in the case of life insurance; and
- (c) Riba: Interest and other related practices that do not conform to the shariah in the investment activities.

## **6.2 Birth of Takaful in Malaysia**

The foundation for the development of Takaful or Islamic insurance was set by the wish of Muslims to realign more to Islamic practices in the economic activities coupled with the strong support from the government for Islamic financial services. In the same manner as conventional banking requires the services of insurance, Islamic banking also needs the services of insurance. It is benefiting that the insurance services for Islamic banking must be based on a system acceptable to Islam.

A special body, "Task Force on the Study of Establishing Islamic Insurance Company in Malaysia", was formed in 1982 to study the possibility of establishing Islamic insurance to complement the services of Islamic banking. Following the recommendation of the task force, Parliament enacted the Takaful Act in 1984. In November 1984, the first Takaful operator, Syarikat Takaful Malaysia Sdn Bhd (STMB), was incorporated with a paid-up capital of RM10 million. Bank Islam Malaysia Bhd held the majority stake in STMB while the other shareholders were the Islamic Religious Councils and Baitulmals of certain states in Malaysia. The paid-up capital of STMB was increased to RM55 million via bonus and right

issue, followed by public flotation of its shares on the main board of the KLSE in July 1996.

In 1988, the Government entrusted BNM with the regulatory and supervisory role over the insurance and takaful industries. As the first takaful operator showed remarkable and stable growth over the first eight years of its business, supported by the favourable demand from the public for Islamic insurance, the Director General of Takaful licensed another takaful company, MNI Takaful Sdn. Berhad (MNIT) in 1993, a subsidiary of a conventional insurer licensed in the country. MNIT changed its name to Takaful Nasional Sdn. Berhad (TNSB) in November 1998. The formation of the second takaful operator was intended to create competition and open a vista for the exchange of business through retakaful (equivalent to reinsurance) and at the same time, increase domestic retention capacity. Its formation was also to accommodate the increased demand for Islamic insurance coverage arising from services provided under the interest-free banking system introduced in 1993.

The ASEAN Takaful Group (ATG), a grouping of takaful operators operating in Brunei, Indonesia, Malaysia and Singapore was formed in October 1995 to enhance mutual cooperation and to facilitate the exchange of business among takaful operators in ASEAN (Yusof, 1996). In an effort to facilitate the exchange of retakaful business among takaful operators in the region, the 'ATG Pool' for fire business was established in October 1996 and STMB was given the mandate to manage the pool. In May 1997, the Malaysian takaful industry took a leap forward with the formation of ASEAN Retakaful International (L) Ltd. (ARIL) as an offshore retakaful company in Malaysia's International Offshore Financial Centre in Labuan. The establishment of ARIL was to create a vehicle for more dynamic retakaful exchanges among ATG members and at the same time, provide additional retakaful capacity to further reduce their dependence on conventional reinsurance. The present shareholders of ARIL are takaful operators in Malaysia, Brunei and Singapore.

### 6.3 Takaful Concept

In Malaysia, the provision of insurance cover as a form of business in conformity with Shariah is based on the following Islamic principles (Yusof, 1996):

- (a) Al-Takaful: The pact among a group of people called participants, reciprocally guaranteeing each other against loss or damage that may befall any one of them;
- (b) Al-Mudharabah: The commercial profit sharing contract between the provider(s) of funds (participants) for a business venture and the entrepreneur who actually conducts the business; and
- (c) Tabarru': The agreement by a participant to relinquish as tabarru', a certain proportion of the takaful contribution that he agrees or undertakes to pay, thus, enabling him to fulfil his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss.

Thus, the operation of takaful may be envisaged as a profit sharing business venture between the takaful operator and the individual members of a group of participants who wish to reciprocally guarantee each other against certain loss or damage endured by any one of them.

The operation of takaful is confined within the "Tijari" (commercial) sector or popularly known as the private sector. The traditional aspects of the commercial activity of takaful must be subject to Islamic contractual laws to ensure its compliance with Shariah. Within this fundamental framework contract of "tijari" takaful is therefore based on the Islamic principle of Mudharabah. The tabarru' concept is incorporated in takaful contract to eliminate the uncertainty element. A



participant shall agree to relinquish as tabarru', certain proportion of his takaful contributions that he agrees of undertakes to pay.

Consequently, this enables him to fulfill his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss. The sharing of profit or surplus that may emerge from the operations of takaful, is made only after the obligation of the assisting the fellow participants is fulfilled. It is imperative for a takaful operator to maintain adequate assets of the defined funds under its care whilst simultaneously striving prudently to ensure the funds are sufficiently protected against undue over-exposure.

## **6.4 Type of Takaful Business**

The commercial activity of takaful is reflected in two basic type of business that it undertakes. Depending on the legal structure and statutory provision, both types of business may either be transacted under a common entity (composite basis) or one entity for each type of business.

The types of business are Family Takaful Business (Islamic life insurance) and General Takaful Business (Islamic general insurance).

### **6.4.1 Family Takaful**

A family takaful plan is a long-term savings and investment programme with a fixed maturity period. Apart from enjoying investment profit, the plan provides mutual financial assistance among its participants. The family takaful plan is a financial programme that pools efforts to help the needy in times of need due to untimely death and other mishaps resulting in personal injury or disablement (BIRT, 1996).

The takaful plans designed by the takaful company would enable participants to participate in a takaful scheme with the following aims:

- (a) To save regularly for a fixed period with a view of creating a kind of retirement or long-term contingency fund;
- (b) To invest with a view of earning profits which are shariah-compliant; and
- (c) To avail of cover in the form of payment of takaful benefits to heir(s) should a participant die before the maturity date of his takaful plan.

#### **6.4.1.1 The Operations of Family Takaful**

A person who participates in any family takaful plan is called a participant. A participant may choose any one of the plans offered by the company. The family takaful plans have a defined period of participation. The takaful company and the participant will enter into a long-term takaful contract, which is based on the principle of Al-Mudharabah (profit-sharing).

The takaful contract spells out clearly the rights and obligations of the parties to the contract. The participant is required to pay regularly the takaful installments in consideration for his participation in the takaful plan. The participant will decide the amount of takaful installments that he wishes to pay, but such an amount shall be subject to the minimum sum as determined by the company.

Each takaful installment paid by the participant shall be divided and credited by the takaful company into two separate accounts, namely the participant's account and the participant's special account. A substantial proportion, for example, such as 93 percent of this installment is credited into his participant's account solely for the purpose of his savings and investment.

The balance is credited into his participant's special account as tabarru' for the purpose of mutual help. Mutual financial assistance such as takaful death benefits to fellow participants is paid from the participant's special account. What proportion of the takaful installment to be relinquished as tabarru' and credited into the participant's special account is determined based on sound actuarial principles.

The takaful installment credited into these two accounts will be pooled as a single fund for the purpose of investment activities undertaken by the takaful company in a manner permitted by the Shariah. Any profits generated from the investment shall be shared between the participant and the company in a ratio to be mutually agreed between the participant and the company in accordance with the contract of Al-Mudharabah. For instance, if the ratio agreed is 7:3 then the participant shall be entitled to 70 percent of the profits whilst the company shall be entitled to 30 percent.

The participant's share of the profits shall be credited into his participant's account. With the accumulation of such profits, the balance in the participant's account will increase over a period of time.

#### **6.4.1.2 Family Takaful Benefits**

In the event that a participant should die before the maturity of his family takaful plan, the following takaful benefits shall be paid to him:

- (a) The total amount of the takaful installments paid by the participant from the date of inception of his takaful plan to the due date of the installment payment prior to his death and his share of profits from the investment of the installments which have been credited into his participant's accounts; and

- (b) The outstanding takaful installments which would have been paid by the deceased participant should he survive. This outstanding amount is calculated from the date of his death to the date of maturity of his takaful plan which shall be paid from the participant's special account as agreed upon by all the participants in accordance with the takaful contract.

If a participant survives until the date of maturity of his takaful plan, the following takaful benefits shall be paid to him:

- (a) The total amount of takaful installments paid by the participant during the period of his participation plus his share of profits from the investment of the takaful installments credited into his participant's accounts; and
- (b) The net surplus allocated to his participant's special account as shown in the last valuation of the participant's special accounts.

In the event that a participant is compelled to surrender or withdraw from the takaful plan before the maturity of his takaful plan, he shall be entitled to the surrender benefits.

The participant is entitled to receive the proportion of his takaful installments that have been credited into the participant's account including his share of investment profits. However, the amount that has been relinquished as tabarru' will not be refunded to him.

#### **6.4.1.3 Types of Family Takaful Plans**

The various types of family takaful plans available in the market are:

- (a) Family takaful plan for education;
- (b) Family takaful mortgage plan;
- (c) Group family takaful plan; and
- (d) Group hospitalisation and medical benefit.

#### **6.4.2 General Takaful Business**

General Takaful Scheme are basically contracts of joint guarantee, on a short-term basis, based on the principle of Al-Mudharabah, between a group of participants to provide mutual compensation in the event of a defined loss. The schemes are designed to meet the needs for protection of both individuals and corporate bodies in relation to material loss or damage consequent upon a catastrophe or disaster inflicted upon properties, assets or other belongings of its participants (BIRT, 1996).

In consideration for participating in the various schemes participants agree or undertake to pay takaful contributions as tabarru' for the purpose of creating a defined asset as illustrated in the "General Takaful Fund". It is from this fund that mutual compensation would be paid to any participant who suffers a defined loss or damage arising from a catastrophe or disaster affecting his property or belonging.

All returns on the investment will be pooled back to the fund. In line with the virtues of mutual help, shared responsibility and joint guarantee as embodied in the concept of takaful, compensation or indemnity will be paid to any participant who suffers a defined loss or damage consequent upon the occurrence of a catastrophe or disaster. Other operational costs for managing the General

Takaful Business such as the cost for arranging retakaful programme and setting-up of reserve shall also be deducted from the Fund.

#### **6.4.2.1 The Operation of General Takaful**

The operations of general takaful basically contracts of joint-guarantee, on a short-term basis (normally one year), between groups of participants to provide mutual compensation in the event of a defined loss. The schemes are designed to meet the needs for protection of individuals and corporate bodies in relation to material loss or damage resulting from a catastrophe of disaster inflicted upon properties, assets or belongings of participants.

In the event of a catastrophe or disaster resulting in a loss or damage to a property or bodily injuries or other physical disability to a person, the owner of the property or the person concerned may suffer substantial financial losses. For instance, if a house is destroyed or damaged by fire, the owner would certainly require a sufficient sum of money to repair the house, or rebuild a new one as well as enough money to replace the damaged furniture, fixtures and fitting.

Similarly, a person being injured in an accident would require an adequate sum of money to pay for the medical treatment. With the various general takaful schemes offered in the market, that person would be assured of takaful benefits in case of misfortune resulting from such loss or damage. Participants of a general takaful scheme shall also enter into a contract with the company on the basis of the contract of Mudharabah. The contract stipulates the right and obligations of the participants as well as the company.

In consideration for participating in the various schemes, the participants agree to pay the takaful contributions as tabarru'. The company manages the general takaful business including managing the investment of the general takaful fund assets. As the Al-Mudharib, the takaful company will invest the general takaful

fund in line with Shariah principles and all returns on the investment will be pooled back to the fund.

In line with the virtues of cooperation, shared responsibilities and mutual help as embodied in the concepts of takaful, the participants agree that the company shall pay from the general takaful fund, compensation or indemnity to fellow participants who have suffered a defined loss upon the occurrence of a catastrophe of disaster.

The fund shall also pay for other operational costs of general takaful business such as for the retakaful arrangements and the setting up of technical reserves. Should there be a surplus (profits) in the general takaful fund after deducting all the operational costs of general takaful, that surplus will be shared between the participants and the company provided the participants has not incurred any claims, and that no takaful benefits have been paid to them.

This sharing of the surplus will be in a ratio agreed in accordance with the contract of Al-Mudharabah. If the ratio agreed is 6:4, then 60% of the surplus will be shared among such participants whilst the balance 40% is the share of the company.

## **6.5 Islamic Insurance – Malaysian Model**

In conformity with Shariah, the operation of takaful in Malaysia is confined within the Tijari or commercial or private sector based on the Islamic principles of Al-takaful, Al-Mudharabah and tabarru' (BNM, 1999). Al-takaful is the pact among a group of people called participants, reciprocally guaranteeing each other against loss or damage that may befall any one of them. Al-Mudharabah is the commercial profit sharing contract between the provider(s) of funds (participants) for a business venture and the entrepreneur who actually conducts the business. Tabarru' is the agreement by a participant to relinquish as tabarru' (to donate, to

contribute, to give away), a certain proportion of the takaful contribution that he agrees or undertakes to pay, thus, enabling him to fulfil his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss.

The concept of tabarru' eliminates the element of uncertainty in the takaful contract. In essence, tabarru' would enable the participants to perform their deeds in sincerely assisting fellow participants who might suffer a loss of damage due to a misfortune. The sharing of profit or surplus that may emerge from the operations of takaful, is made only after the obligation of assisting the fellow participants has been fulfilled. Thus, the operation of takaful may be envisaged as a profit sharing business venture between the takaful operator and the individual members of a group of participants who desire to reciprocally guarantee each other against a certain loss or damage that any one of them may suffer.

The operations of takaful business in Malaysia are governed by the Takaful Act 1984. The legislation provides that the Articles of Association of a takaful operator must have a provision for the establishment of a Shariah Supervisory Council which should advise the takaful operator on its takaful operations and ensure that the takaful operator is not involved in any elements contrary to the Shariah. In an effort to create uniformity in the Islamic banking and takaful industries, BNM established National Syariah Advisory Council for Islamic Banking and Takaful in May 1997. The council has issued opinions, including opinions on new Islamic financial instruments and the practices of banking and takaful operations.

Takaful operations are regulated and supervised by BNM since 1988 with the appointment of the BNM Governor as the Director-General of Takaful. There are presently two takaful operators, namely Syarikat Takaful Malaysia Berhad (STMB) and Takaful Nasional Sdn. Berhad (TNSB) operating a total of 118



takaful offices throughout the country. For the financial year ending in 2000, total assets of the family takaful funds and the general takaful funds amounted to RM877 million and RM291 million respectively.

## **6.6 Development of the Takaful Industry in Malaysia**

When the concept of takaful was first introduced to the Malaysian public in 1985, the majority of the population was still not aware of the importance of insurance. To most people, insurance cover was synonymous with motor insurance and was merely bought to fulfil the requirement of the law. The task set upon the first takaful operator was to disseminate information and create awareness among the public on the importance of insurance cover and the need for takaful as an alternative to conventional insurance. The focus was mainly on the Muslim population, a natural choice as takaful is based on Shariah principles.

During the first five years, takaful business was concentrated in the general takaful products, which were easy to sell. In 1989, motor takaful business constituted 64.8 percent of the total gross contribution, followed by fire takaful with 24.7 percent. At this stage, the strategy was only to provide takaful schemes to cater to the needs of individuals. The group takaful plan was only introduced in mid 1988 to provide personal accident takaful cover to groups of people such as workers' unions, professional associations and co-operatives while the marine cargo takaful plan was introduced in 1991. As the business grew and realizing the potential for business, there was an increased emphasis on family takaful business. More new family takaful products were introduced, for example health takaful and takaful for children education. Marketing staffs were recruited to specialize in the sale of family takaful products. With the shift in emphasis, family takaful business accounted for 66.7 percent of total contribution income of family and general takaful business in 1998, compared with only 30.6 percent in 1989.

The distribution channel employed by the first takaful operator is unique, as it does not use the traditional agency system for marketing its takaful products. It relies on its branch network and full time marketing staff to sell its products. This however, did not set a tradition as the second takaful operator preferred to market its takaful plans through the traditional distribution channel of agencies.

## **6.7 Measures Taken to Develop and Promote the Takaful Industry**

In Malaysia, the potential for takaful business is enormous. This is attributed to two major factors, namely, the low market penetration of 28.4 percent and the fact that over half of the Malaysia population are Muslims. The high level of religious tolerance and acceptance among the Malaysian community also contributes to the potential for takaful to penetrate the non-Muslim market. The attractive features of takaful products, one of which is the *Al-Mudharabah* or profit-sharing element, also makes takaful an attractive alternative to insurance.

Recognizing the potential for takaful growth in Malaysia, BNM is committed to developing the takaful industry to complement the conventional financial system. One of the major steps undertaken was the formulation of a five-year strategic plan for the takaful industry. The objectives of the strategic plan are to formulate new strategies to position the takaful industry as one of the key components of the financial system and to promote takaful as a viable alternative to conventional insurance. The strategic plan sets specific targets in terms of assets size and the level of market penetration for the takaful industry to achieve by the end of the five-year period. Part of the strategy is the possibility of issuing new licenses to carry on takaful business as an effort to increase market penetration. Efforts are also under way to develop the country as a center for takaful training and consultancy services.

A comprehensive review of the existing Takaful Act is being undertaken with the aim of making the legislative framework governing the takaful industry more

effective and relevant, not only to present day circumstances, but also to the future. To be modeled after the Insurance Act 1996, the revised law would further strengthen the supervisory role of BNM, ensure better accountability on the part of takaful operators, strengthen their financial standards as well as accord greater protection to takaful participants and members of the public. New statistical forms, accounting standards and model accounts for takaful operators will also be introduced to enable better analysis and more effective monitoring of the performance of takaful operators as well as to facilitate greater disclosure in their financial statements and improve transparency in their operations.

The availability of a trained and skilled workforce is essential for the rapid development of the takaful industry. The Malaysian Insurance Institute (MII) and BIMB Institute of Research and Training Sdn. Bhd. (BIRT) are expected to take the lead in developing and designing training programmes to suit the needs of the industry as well as in providing consultancy services in takaful. Emphasis will also be given to research and developmental work in takaful.

In the international arena, Malaysia is a member of the Developing-8 Group (D-8), an arrangement for development cooperation among eight developing countries under the sub-set of the Organisation of Islamic Conference namely Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey. Under the D-8 platform, Malaysia has expressed willingness to extend the knowledge and expertise gained in takaful business to the group members and other countries. With this intention in mind, Malaysia has organised a number of fora on takaful as part of the training programme offered to D-8 members. For example, an "International Workshop on Retakaful" was held in Kuala Lumpur from 31 May – 1 June 1999. The takaful operators have also been active in conducting training programmes on takaful locally and abroad and providing technical assistance and cooperation in the establishment and management of new takaful companies.

## **6.8 Summary**

Insurance, especially life insurance is an essential part of the social protection needed for any society. It has its rightful place in Islam but years of misunderstanding and misconception have created mental blocks against insurance in the Muslim culture. We believe Takaful or Co-operative Insurance is the right way forward towards the breakdown and removal of such mental blocks. This type of insurance has great deal to offer in Muslim countries where the spread of insurance per person and percent of GDP can increase manifold if the system of takaful is projected correctly and understood properly. It can genuinely enlarge the insurance market in areas where traditional insurance has not been able to grow, as it should have done. This is true of personal lines, especially of life insurance or family takaful.

In order to create the essential trust and confidence, which is needed to remove the mental blocks just mentioned, the efforts to develop and manage takaful business must be genuine. Investors, entrepreneurs and insurers have good opportunity to take up the challenge of developing insurance business on Islamic principles. After all takaful is intrinsically in accordance with indigenous consumer needs.

What has been attained so far is comparatively small, but as shown from the performance of takaful operators generally, is growing rapid. Considering only a tiny percentage of the ummah have some form of life insurance cover, the potential for takaful to penetrate deeper into the market is tremendous. In this context family takaful products would have strong chance to grow and expand. Therefore takaful is here to stay.

However, the future of takaful would depend on the ummah. Whether takaful would develop into an industry and eventually become the real insurance alternative for the ummah would depend on the commitment and political

willingness of the muslim at the individual, community, national and international levels. What is urgently needed is the practical translation of these commitment and political willingness by all.

The time for polemic is past; it is no more discoursing on the basic issue of 'halal' or 'haram'. The way forward is on improving, correcting and developing the existing operational structure, which has been generally accepted to be essentially based on either the principles of Al-Mudharabah or Al-Wakalah. It is clearly demonstrated that in countries where there is commitment and strong political willingness plus the application of modern management practices in its approach, countries have seen their takaful operation grow into a viable and profitable business venture.

## References

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